In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613

In the Matter of
THE VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and
FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,
Respondents.

(A. B. GOCHENOUR, ET AL., *Interveners.*)

PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit, and
BRIEF IN SUPPORT THEREOF

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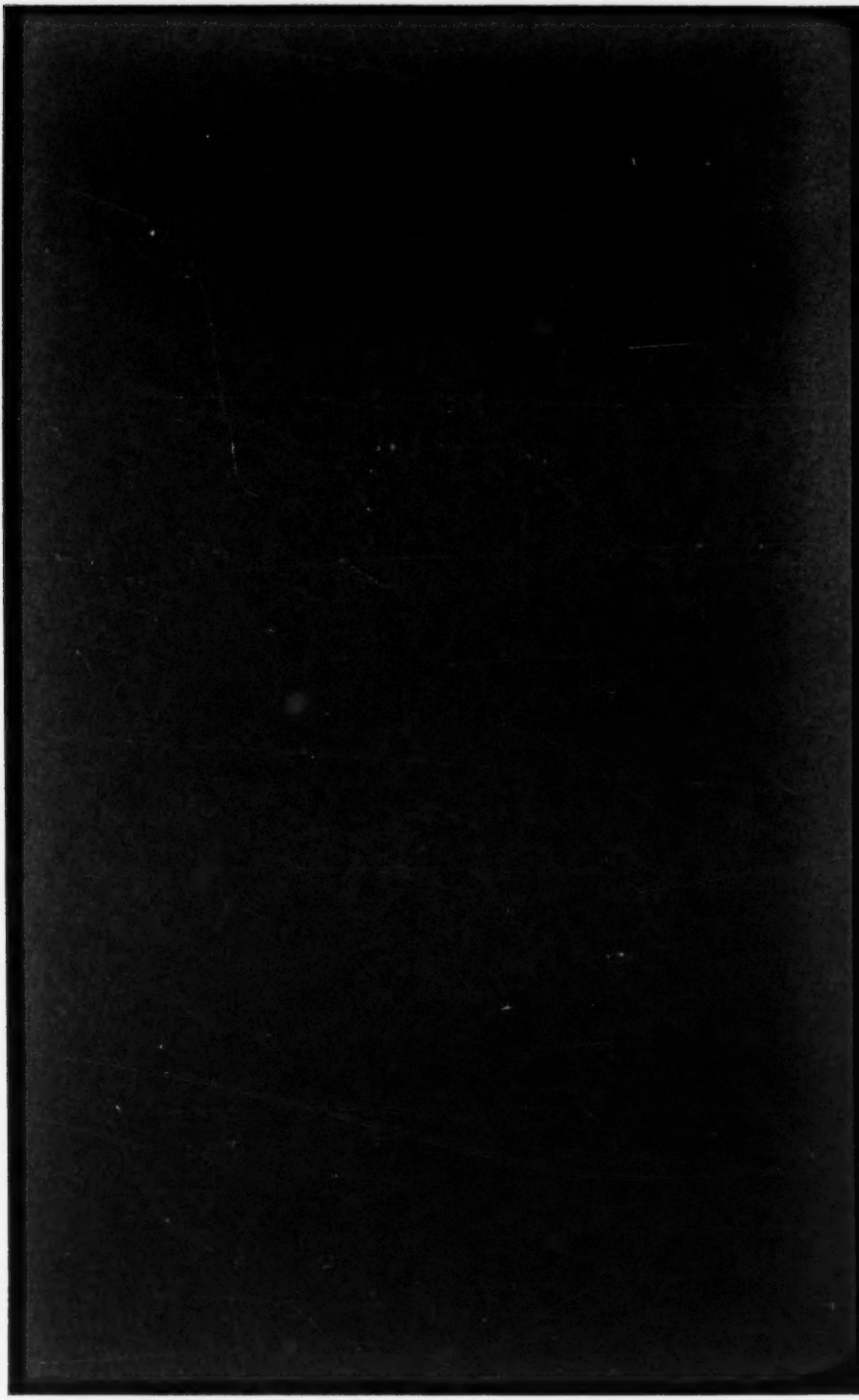

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FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,
Respondents.

PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit.

The Terminal and Shaker Heights Realty Company (successor by change of name to Midamerica Corporation and hereinafter referred to in this petition and supporting brief as "Midamerica") prays that a writ of certiorari be issued to review an order of the Circuit Court of Appeals for the Sixth Circuit entered in this cause on April 16, 1941. This order affirmed an order of the District Court for the Northern District of Ohio, Eastern Division, disallowing, except for $887, a claim by Midamerica against Van Swer-

ingen Corporation (hereinafter called "the Debtor") in the principal amount of $13,787,000, evidenced by 6% Gold Notes of the Debtor.

Midamerica's petition for a rehearing below was denied on June 25, 1941. (R. 341.)*

OPINION BELOW.

The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 320-328) is reported in 119 Fed. (2d) 231 (1941).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 24(c) of the Bankruptcy Act (U. S. C. A. Title 11, Section 47(c)) and under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. A. Title 28, Section 347).

QUESTIONS PRESENTED.

(1) Did Midamerica acquire good title to the notes of the Debtor which it purchased from J. P. Morgan & Co. at public auction sale on September 30, 1935, as a part of the collateral securing a $16,000,000 loan from J. P. Morgan & Co. to The Vaness Company, or was Midamerica debarred from acquiring good title because O. P. and M. J. Van

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* The Circuit Court of Appeals for the Sixth Circuit by the same decision in 119 Fed. (2d) 231 (1941) dealt with the two companion cases of *Midamerica v. The Van Sweringen Company* and *Midamerica v. The Cleveland Terminals Building Company* and likewise disallowed, except for nominal amounts, claims of Midamerica against The Van Sweringen Company and The Cleveland Terminals Building Company. In the three cases taken together, claims of Midamerica aggregating $21,248,697, for which all three debtor companies admittedly received full value, were allowed for only $890. Midamerica has filed petitions for certiorari in these two related cases which were argued together below and which involve substantially the same questions of fact and law.

All references are to the record below, except for references to the record in *The Cleveland Terminals Building Company* case, which is designated "C. T. B. record."

Sweringen were officers and directors of Midamerica and also officers and directors of the Debtor?

(2) In the reorganization proceedings of the Debtor under Section 77B (now Chapter X of the Bankruptcy Act), should the rule which forbids a director to profit at the expense of his insolvent company by buying up its notes at a discount be applied to a case where the director did not seek and could not make a profit, but only sought to reduce a personal liability resulting from his guarantee of a $16,000,000 loan to The Vaness Company for which the notes of the Debtor were pledged as collateral?

(3) Even if O. P. and M. J. Van Sweringen were personally disqualified from buying the notes of the Debtor, was Midamerica also disqualified despite the fact that it was wholly owned by third parties?*

STATEMENT.

In this case directors who had personally guaranteed $39,500,000 of loans to their companies were denied the right, upon foreclosure of the loans, to purchase part of the pledged collateral in order to protect themselves against liability on their guaranties.

(a) The $39,500,000 Loans of J. P. Morgan & Co. to The Vaness Company and The Cleveland Terminals Building Company.

In October, 1930, The Vaness Company, a holding company of O. P. and M. J. Van Sweringen, and its subsidiary, The Cleveland Terminals Building Company (hereinafter called respectively "Vaness" and "C. T. B." in this peti-

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* For the purpose of presenting the reasons why certiorari should be granted, and only for that purpose, Midamerica assumes that it stands in the shoes of the Van Sweringens, and therefore makes no point at this time of Question (3). Midamerica, however, reserves the right, if certiorari is granted, to contend, as it has contended throughout, that wholly different and additional defenses are available to it from those which would be available to the Van Sweringens themselves.

tion and supporting brief) were in serious need of funds, and O. P. Van Sweringen, on their behalf, entered into negotiations with J. P. Morgan & Co. to secure a loan of $16,000,000 to Vaness and $23,500,000 to C. T. B. J. P. Morgan & Co. would not make the requested loans except upon two conditions: (a) that the Van Sweringens personally guarantee payment of both the loans; and (b) that approximately $15,000,000 of debts of Vaness be paid before the loans were made. (R. 176, 178, 179, 203; C. T. B. record, pp. 123-124, 243, 263.)

Both conditions were met. The $15,000,000 of Vaness debts were cancelled in consideration of their assumption by the Van Sweringens personally, who thereby made a contribution to the surplus of Vaness of nearly $15,000,000 (R. 153-155, 176), and the Van Sweringens personally guaranteed the two loans aggregating $39,500,000, which were made on October 31, 1930. (R. 149; C. T. B. record, pp. 123-124, 243, 263.)

The Vaness loan was secured by the pledge of virtually all the securities belonging to Vaness, among which were the $13,787,000 principal amount of 6% Gold Notes of the Debtor, 71% of whose common stock (the only class outstanding) was owned by Vaness. (R. 27, 24-25.) These notes were originally issued for full value by the Debtor (R. 25), and their enforceability in full in the hands of Vaness has never been questioned.

After 1930, economic conditions became worse.* Vaness and C. T. B. were unable to pay the interest on their loans and, with the consent of the Van Sweringens as guarantors, secured an extension of time for the payment of interest and gave interest notes, also guaranteed by the Van Sweringens. (R. 155; C. T. B. record, pp. 126, 142, 191.) From August, 1934, to the maturity of the loans on May 1, 1935, O. P. and M. J. Van Sweringen made repeated but unsuc-

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* This Court may take judicial notice of this trend, *Great Northern Ry. Co. v. Weeks*, 297 U. S. 135 at 149.

cessful efforts to refund or extend them (R. 156-158; C. T. B. record, pp. 124, 144-145, 243, 263), and at maturity Vaness, C. T. B. and the Van Sweringens admitted their inability to pay them. (R. 181-182; C. T. B. record, p. 168.)

On September 13, 1935, J. P. Morgan & Co. published a notice of the sale of the collateral securing the Vaness and C. T. B. loans, to be held September 30, 1935. (R. 58-66; C. T. B. record, pp. 52-59.)

The notice of sale divided all the collateral to be sold into 58 parcels comprising four groups. The Debtor's notes were Parcel 24, included in Group 1. The parcels were first to be offered for sale separately and then in groups, and if the group bid exceeded the aggregate of the parcel bids, all the parcels were to be sold as a group. (R. 61-63.) Any bidder desiring to qualify was required to deposit, in cash or by certified check, by 11 o'clock on the day of the sale, the various amounts specified in the notice of sale. The amount required to qualify to bid on Parcel 24 was $250, but the amount required to bid on Group 1 was $270,000. (R. 64.)

Groups 1 and 3 comprised securities of the companies which were being managed by the Van Sweringens. (R. 191.) The sale was to be conducted by Adrian H. Muller & Son, well known securities auctioneers of New York, and was widely advertised for two weeks in newspapers of general circulation in New York City and so was widely publicized. (R. 27, 158.) This was in accord with the stated purpose of J. P. Morgan & Co. "to give the widest notice to all possible bidders." (C. T. B. record, p. 176.)

At the time of the auction sale the Debtor was hopelessly insolvent. It had cash on hand of $13.67. (R. 97.) Its liabilities exceeded $21,000,000, and its only assets were the stock of, and a large unsecured claim against, C. T. B. which was likewise insolvent. (R. 97-99.) In October, 1936, just a year after the sale, the Debtor—along with its sub-

sidiary C. T. B.—was forced to initiate proceedings for reorganization under Section 77B of the Bankruptcy Act which are still pending. (R. 2.)

(b) The Formation of Midamerica Corporation and the Purchase at the Morgan Auction.

Midamerica was formed on September 28, 1935, for the purpose of bidding at the Morgan public auction sale for the securities of those companies which were being managed by the Van Swerin[illegible]ns. (R. 28, 66-68.) All the capital stock of Midamerica was subscribed for and purchased by George A. Ball of Muncie, Indiana, and G. A. Tomlinson of Cleveland, Ohio, at a cost of $2,015,000, being 20,000 shares of preferred stock at $100 per share, and 15,000 shares of common stock at $1.00 per share. (R. 29, 67.) Ball and Tomlinson were willing to invest their money only upon the assurance of continued Van Sweringen management (R. 66-68); and to this end they granted to O. P. and M. J. Van Sweringen a ten-year non-assignable option to purchase at cost 55% of the common stock of Midamerica at any time when the Van Sweringens could satisfy five of the six directors of Midamerica that they had "paid or adjusted any and all claims" against them based upon existing or future "commitments or relationships." (R. 67.)

The original directors of the corporation, chosen by Ball and Tomlinson as the sole stockholders, were George A. Ball, G. A. Tomlinson, F. B. Bernard of Muncie, Indiana (a close business associate of Ball who had had no previous connection with the Van Sweringens), O. P. and M. J. Van Sweringen, and Charles L. Bradley (a close business associate of the Van Sweringens). (R. 29.)

Even if the Van Sweringens had voted the optioned shares, which they never did (R. 151-152), they could not have elected a majority of the board of directors because of the provision in the articles of the corporation for cumulative voting, which limited to three the number of direc-

tors which 55% of the common stock could elect. Six directors were provided for and restrictions in the corporate articles and regulations required the vote of five out of these six for (1) enlarging the board, (2) merger, consolidation, or sale of substantially all the corporation's assets, (3) issuance of any new shares, and (4) initiation of any amendments to the corporation's articles or regulations. (R. 68-73.) Thus, although the Van Sweringens were the chief executive officers, they did not—and could not—control the board.

O. P. Van Sweringen was elected president and M. J. Van Sweringen vice-president. Other members of the Van Sweringen administrative organization were elected to the other offices. (R. 29.)

On September 30, 1935, at a meeting of the board of directors attended by all the directors except Bradley, it was resolved that the corporation should qualify as a bidder for Group 1 (embracing Vaness collateral) and for Group 3 (embracing C. T. B. collateral) to be sold at the Morgan sale and that the president or his nominee be authorized to bid for all or any part of the securities in Group 1 and Group 3. (R. 76.) The sale was held on the same day. (R. 31.)

After the securities were offered by parcels, Midamerica made a group bid on the securities in Group 1 and Group 3 which was in excess of the aggregate bids on individual parcels, and all the parcels in these groups were, therefore, sold to it. The purchase price for Group 1 was $2,803,000 (R. 31), and the purchase price for Group 3 was $318,000. (R. 30.) The aggregates of the parcel bids for the respective groups were $2,802,102 and $317,127. (R. 108-110.) Included in Group 1 were the notes on which the claim against the Debtor is founded. Also purchased were common stock of the Debtor, stock and notes of the Van Sweringen Company, large amounts of stock of Alle-

ghany Corporation (a railroad holding company theretofore controlled by Vaness), and numerous other securities of Van Sweringen enterprises. (R. 58-61.) A list of all the 28 parcels comprising Group 1 appears in Appendix A of petitioner's supporting brief.

For purposes of accounting, it was necessary for Midamerica to establish a cost basis for the securities purchased. Accordingly, on October 31, 1935, J. J. Anzalone, treasurer of Midamerica, requested from the auctioneer a list of the individual bids at the auction. On the basis of this he established a book cost of the various parcels. For those parcels on which there were individual bids he took the individual bids. For those parcels on which there was no individual bid he arbitrarily used the sum of $1.00. However, since the bulk bid exceeded the parcel bids, this left an excess of $887, which was arbitrarily assigned to the notes of the Debtor. (R. 31-32.)

Inherent in "participation in the management and direction" of Midamerica by the Van Sweringens was the payment to them of a reasonable compensation. The compensation took the form of a drawing account which amounted to $100,000 per year for their joint services. (R. 271.)

Both O. P. and M. J. Van Sweringen were dead before the end of 1936. Each was liable upon indebtedness aggregating more than $50,000,000 (created mainly by their guaranties of the obligations of Vaness and C. T. B.) and each had relatively negligible assets. They died without paying or adjusting any of their debts existing at the time of the formation of Midamerica, and the option died with them. (R. 33, 166, 167, 67.)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals for the Sixth Circuit erred—

(1) In holding that Midamerica's claim of $13,787,000 against the Debtor should be disallowed except to the extent of $887 and in affirming the order of the District Court to that effect;

(2) In holding that the guaranty by O. P. and M. J. Van Sweringen of J. P. Morgan & Co.'s $16,000,000 loan to Vaness had no bearing upon the right of the Van Sweringens to protect themselves against loss and continuing liability through the acquisition of an interest in the Debtor's notes as a portion of the collateral which secured the Vaness loan;

(3) In failing to apply the doctrine of *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 and *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312, holding that a director has the right to protect legitimately acquired interests;

(4) In finding that the Van Sweringens realized a profit from Midamerica;

(5) In completely disregarding the corporate entity of Midamerica and treating it as a creature of the Van Sweringens;

(6) In finding bad faith on the part of the Van Sweringens.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.
2. If the Conflict With the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict With the State Law.

3. **The Decision Below Conflicts With Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.**
4. **The Decision Below, by an Overzealous Application of *Pepper v. Litton*, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by This Court and, in Fact, Undermines a Director's Duty of Loyalty.**

Petitioner's brief in support of this petition is annexed hereto.

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